Estonia

Estonia: Pension system in 2020

The system combines an earnings-related public scheme with mandatory contributions to funded pensions. There is also a flat-rate, basic element and a safety-net, national pension.

Key indicators: Estonia

		Estonia	OECD
Average worker earnings (AW)	EUR	16 637	34 301
	USD	19 002	39 178
Public pension spending	% of GDP	6.5	7.7
Life expectancy	at birth	78.2	80.6
	at age 65	18.1	19.7
Population over age 65	% of working- age population	34.9	30.4

Qualifying conditions

In 2021 the pension age is 64 years for both men and women. The pension is increasing gradually to 65 by 2026 for both men and women and thereafter is linked to increases in life expectancy. The qualification period is at least 15 years of pensionable service.

Benefit calculation

Basic

The flat-rate base amount was EUR 215.51 per month in April 2020 and is only payable along with an earnings-related pension.

Earnings-related

The earnings-related or so-called insurance component of old-age pensions is calculated based on the amount of contributions paid on an individual's behalf relative to the average contribution paid. The accumulation of the insurance components at retirement is multiplied by the value of one year of pensionable service to calculate pension entitlements. The value of a year of pensionable service was EUR 7.104 in April 2020**.**

There is no ceiling to earnings for contribution or benefit purposes.

Pensions in payment are indexed each April to 20% consumer prices and 80% contribution revenues. This applies to the base amount, the value of a year of pensionable service in the earnings-related component and the value of the national pension under the targeted scheme.

The new part of the pension formula

From 2021 onwards, the fourth part of the pension formula, which is called the compound part, will be collected. The compound part is a symbiosis of length of service and insurance component.

As a result of the change in the pension formula, first pillar pensions will not become as unequal as they would have become only with a three-part pension formula. If the insurance component of a person who has received twice the average wage in Estonia is 2.0 until the end of 2020, then since 2021, the compound component of the same person will be 1.5. At the same time, up to the end of 2020, the insurance component of a person who received half the average wage in Estonia was 0.5, but since 2021, his/her compound component is 0.75.

Flexible old-age pension

From 2021 onwards, people can choose the most suitable time for retirement, suspend their pension if they wish, or take half the pension. The concept of a flexible pension is based on actuarial neutrality: the size of the entire pension asset is the same regardless of the time of retirement, the suspension or partial withdrawal of the pension.

Pension reductions and increases will depend on the time of retirement, the lifetime table of Statistics Estonia and the interest rate curve of the current values of central government debt securities published by the European Central Bank in the euro area. The life table and interest rate data used to calculate the multiplier for reducing and increasing the old-age pension will be updated once a year on 1st of January.

Person can increase his or her old-age pension (half-size to full size) or reduce it (from full to half-size) or stop it once a month, or 12 times a calendar year. The amount of the pension will be changed at the beginning of the next month, as pensions will be paid for the same month in the current month.

Earlier retirement has been restricted in terms of pension qualifying period, as it keeps people from retiring too soon with a pension which is too small. If the general pension qualifying period is 15 years, in case of retiring up to one year before the retirement age one can retire with at least 20 years of pension qualifying period, up to two years before 25 years of qualifying period, up to three years before 30 years of qualifying period, up to four years before 35 years of qualifying period and up to five years before 40 years of qualifying period.

Targeted

A minimum pension guarantee is provided by the national pension. This was EUR 221.63 in April 2020.

The national pension is granted to those who have reached pension age but have not made sufficient contributions for an old-age pension and who have either been permanent residents of Estonia or have resided in Estonia on the basis of a temporary residence permit or temporary right of residence for at least five years immediately before making a pension claim.

It is possible to also apply for a social assistance benefit if the income is less than a certain level. The benefit amount depends on household size, income and housing costs etc. It is granted by local governments.

Defined contribution

The funded pension (second pension pillar) is based on preliminary financing – a working person himself or herself saves for his or her pension, paying 2% of the gross salary to the pension fund. The state adds 4% from the 33% social tax calculated on the salary of the employee. It means that 4% of that state pension will be transferred to insure everyone's personal future and that part will not be paid as state pension.

Until 2021, subscribing to the funded pension was mandatory for the persons who were born in 1983 and later. The right and obligation to pay the contributions arises on 1 January of the year following the year when a person becomes 18 years old.

From 1 January 2021 accumulating a pension in the second pillar has become voluntary. These changes provide the following new options for those accumulating pensions: 1) people have been given the right to decide whether to accumulate pension money into the second pillar or not – for both those who have already enrolled in the second pillar when the changes enter into force, as well as for those who have not; 2) in addition to accumulating money in pension funds, money can be accumulated via pension investment accounts; 3) people have been given the right to use the money accumulated in the second pillar under certain conditions while they are still accumulating their pensions; 4) upon reaching retirement age, each person will be able to decide how to use the accumulated money.

Second pillar social tax suspension

Estonia will temporarily suspend the payment of employer contributions to the second pension pillar, except for employees borne between 1942 and 1960. This suspension will happen from 1 July 2020 until 31 August 2021. Members will have the option of stopping their contributions as well by applying for a suspension in October 2020. The suspension of employee contributions will apply between 1 December 2020 and 31 August 2021.

In 2023-2024, the state budget will finance the missing 4% employer contributions for every month employees continue to make their 2% contributions between 1 July 2020 and 31 August 2021. This amount will be paid into second pillar pension plans. The state will also finance a return on these missing contributions. This return will correspond to the average return of second pillar pension plans between 1 July 2020 and 31 December 2022.

Variant careers

Early retirement

The public pension can be claimed up to five years before the standard pension age provided that the individual retires and if the condition of a 40-year qualification period is met. Pension reduction depends on the time of retirement, the lifetime table of Statistics Estonia and the interest rate curve of the current values of central government debt securities published by the European Central Bank in the euro area.

Late retirement

The public pension can be deferred after the normal pension age. Deferring the pension earns an increment that depends on the time of retirement, the lifetime table of Statistics Estonia and the interest rate curve of the current values of central government debt securities published by the European Central Bank in the euro area. During the deferral period, the worker continues to contribute and earn extra entitlement. It is also possible to combine work and pension receipt. In this case, contributions are again paid and the pension is recalculated annually.

Childcare

The state pays the employer contribution on behalf of recipients of childcare allowance up to three years per child. This is 20% on assumed earnings of the minimum wage (EUR 584 in 2020).

From 2013 the system was improved. One parent will get monthly contributions equal to 4% of national average wage into the funded defined contribution pension scheme for a maximum duration of three years per child for children born after 2013. In addition, parents will get up to three pensionable service years per child for children born before 2013. This rule depends on the exact date of birth, since some parents already have an extra pensionable service yeas per child due to the old rules.

Unemployment

There are no credits for periods of unemployment.

Self-employed

The self-employed are covered by the same pension schemes as employees and they pay the nominal contribution rate equal to the total contribution rate of employees and employers. The contributions are paid on income from the self-employment after deduction social-security contributions.

Personal income taxes and social security contributions

Taxation of pension income

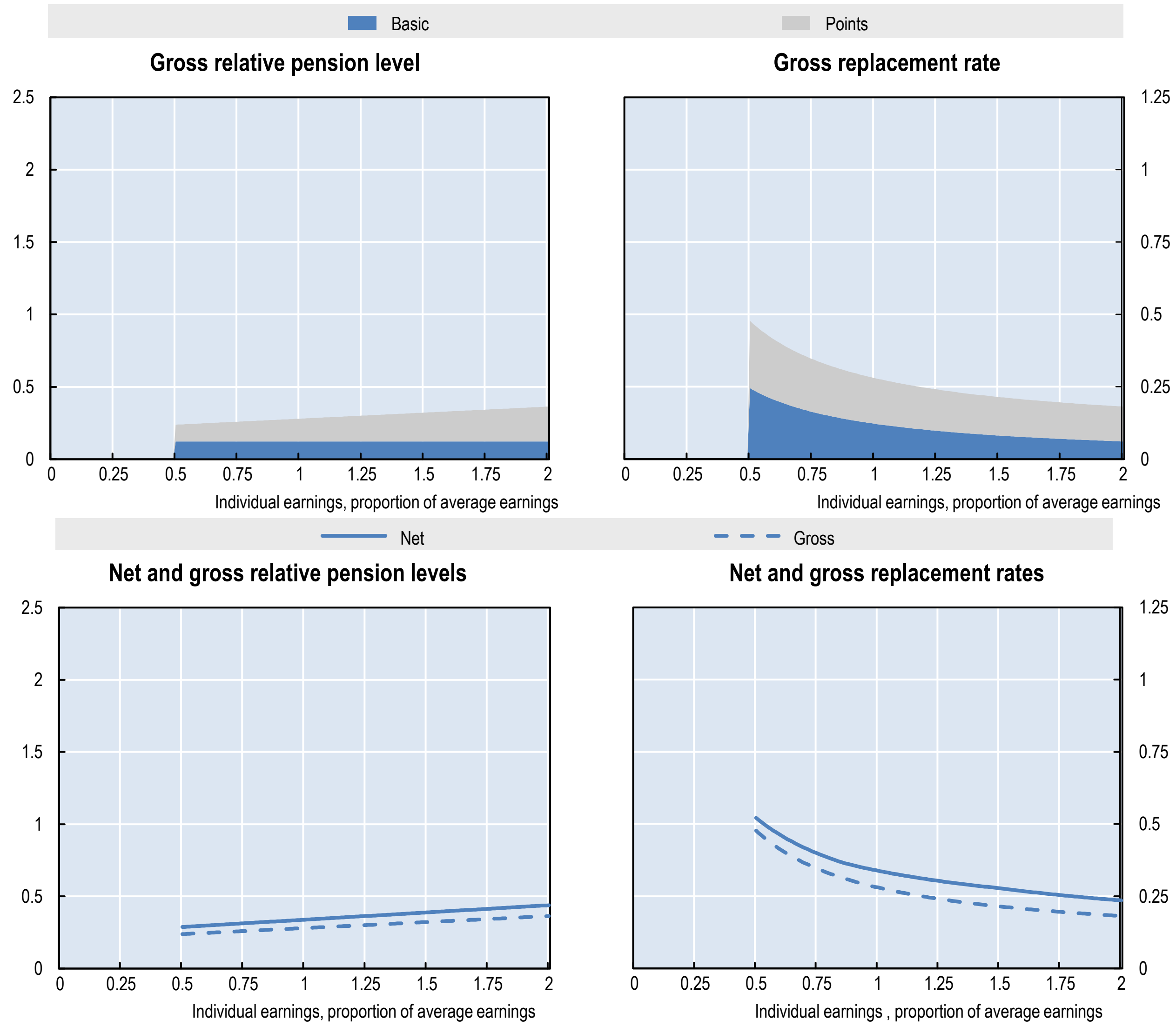
Pension payments count as taxable income. Beginning from 1 January 2018 the overall tax-free amount (non-taxable allowance) of up to 6000 euros per year or up to 500 euros per month will be applied on all types of income and the increased basic exemption on pensions will not be applied. Accordingly, only pension income exceeding EUR 500 per month was subject to income tax (20%) in 2020.

Taxation of pensioners

Social security contributions paid by pensioners

Pensions in payment are not liable for social security contributions.

Pension modelling results: Estonia in 2069 retirement at age 71



Men	Individual earnings, multiple of average					
Women (where different)	0.5	0.75	1	1.5	2	3
Gross relative pension level	23.9	26.0	28.0	32.2	36.4	44.7
(% average gross earnings)						
Net relative pension level	28.8	31.3	33.8	38.9	43.8	51.9
(% net average earnings)						
Gross replacement rate	47.7	34.6	28.0	21.5	18.2	14.9
(% individual gross earnings)						
Net replacement rate	52.1	39.9	33.8	27.8	23.5	18.6
(% individual net earnings)						
Gross pension wealth	6.8	4.9	4.0	3.0	2.6	2.1
(multiple of individual gross earnings)	7.7	5.6	4.5	3.5	2.9	2.4
Net pension wealth	7.4	5.6	4.8	3.9	3.3	2.6
(multiple of individual net earnings)	8.5	6.5	5.5	4.5	3.8	3.0

Assumptions: Real rate of return 3%, real earnings growth 1.25%, inflation 2%, and real discount rate 2%. All systems are modelled and indexed according to what is legislated. Transitional rules apply where relevant. DC conversion rate equal 90%. Labour market entry occurs at age 22 in 2020. Tax system latest available: 2020.